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DE RUEHPE #1114/01 2161913
ZNR UUUUU ZZH
P 041913Z AUG 09
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TO RUEHC/SECSTATE WASHDC PRIORITY 0991
INFO RUEHAC/AMEMBASSY ASUNCION PRIORITY 2532
RUEHBO/AMEMBASSY BOGOTA PRIORITY 6751
RUEHBR/AMEMBASSY BRASILIA PRIORITY 8468
RUEHBU/AMEMBASSY BUENOS AIRES PRIORITY 4036
RUEHCV/AMEMBASSY CARACAS PRIORITY 1463
RUEHLP/AMEMBASSY LA PAZ AUG 5258
RUEHMN/AMEMBASSY MONTEVIDEO PRIORITY 9795
RUEHQT/AMEMBASSY QUITO PRIORITY 2709
RUEHSG/AMEMBASSY SANTIAGO PRIORITY 2550
RHEHAAA/NATIONAL SECURITY COUNCIL WASHINGTON DC PRIORITY
RUMIAAA/USCINCSO MIAMI FL PRIORITY

UNCLAS LIMA 001114

SENSITIVE
SIPDIS

E.O. 12958: N/A
TAGS: [PGOV](#) [PREL](#) [PINR](#) [PTER](#) [PHUM](#) [USAID](#) [OVIP](#) [PE](#)
SUBJECT: SCENE SETTER FOR CODEL PRICE

¶1. (SBU) Summary: Peru is a close U.S. partner in a complicated South American region. Our bilateral relationship is anchored in a shared vision of opportunities and challenges - specifically, that a pro-growth strategy is best suited to reduce poverty and that strengthening institutions is the most effective way to confront drug-trafficking, terrorist remnants and, ultimately, increase support for democracy. Peru's strong macro-economic performance has limited the domestic effects of the international slowdown. Politically, Peru is finding a way forward in a dialogue process following violence in the Amazon region that left 24 police and 10 civilians dead. The objective of your visit - to establish formal legislature to legislature ties - is welcome among Peruvian representatives eager to improve Congress's sagging image. End Summary.

Free-Market Pragmatism

¶2. (SBU) Peru is a close U.S. partner in a South American region characterized by contrary political cross-currents. On one side is the "Bolivarian" project embodied by Governments of Venezuela, Bolivia and, to a lesser extent, Ecuador. On the other side stands Peru, along with Chile, Colombia, Mexico, Brazil and others. Emblematic of the pragmatic approach, Peru has actively opened its doors to foreign trade and investment -- signing free trade agreements not only with the U.S., but also Canada, China, EFTA (Norway, Iceland, Lichtenstein, Switzerland) and negotiating with the European Union, Japan, and South Korea -- and sought to consolidate its still fragile democratic institutions with incremental reforms rather than sweeping visions.

¶3. (SBU) Since 1990, successive Peruvian governments dominated by different political parties have adhered to a free-market system, following sound fiscal and monetary policies. These policies have brought steady and relatively high economic growth, low inflation as well as slow but steady reduction of former extremely high poverty and unemployment levels. These successive administrations have mostly avoided populist policies, and the general population has increasingly supported foreign investment, reduction of import duties, and free competition.

¶4. (SBU) Peru's strong macro-economic performance has limited the domestic effects of the international slowdown, even as export earnings have fallen, some jobs have been lost in key mining and textile sectors, and the local stock market has followed volatile global trends. Peru's high foreign exchange reserves, low debt and limited exposure to the core

structural causes of the crisis, particularly toxic real estate assets and other risky credit, have enabled it to weather the storm relatively smoothly so far. However, for the first time in eight years, in April, Peru experienced negative monthly GDP growth following general declines in growth since October 2008. While it is uncertain whether Peru's economy has touched bottom, many analysts still believe that projected growth this year will reach 2-3% -- the highest in Latin America.

Close U.S. Partner

15. (SBU) Our partnership with the Government Peru is anchored in a similar vision of the opportunities available to us and the challenges facing us here in Peru and throughout the region. For example, we see eye to eye with the government regarding the central importance of a pro-growth strategy in reducing poverty and inequality. There has been some progress on this front. Peru's strong economic growth, averaging approximately 7% over the past eight years, has begun to chip away at poverty -- which fell from 54% in 2003 to 36% in 2008. Peru's longer-term challenge is to make sure that the benefits of sound economic management and continued growth are better distributed and accrue to all Peruvians, especially the poor. In this sense, Peru is in a kind of race against time to make sure the benefits of the pragmatic model are sufficiently widespread so as to prevent the political rise of a serious anti-system political movement in the 2011 national elections.

16. (SBU) We also support the government in confronting drug trafficking and remnant Sendero Luminoso (SL) terrorist elements -- the other central challenges to Peru's continued advancement. To this end, we are working with the Peruvian government to strengthen still fragile public institutions, including security forces; to improve the service delivery capabilities of democratic government, from the national to the municipal and district levels; and to expand state presence into remote areas where criminals and small numbers of terrorists influence economic activity, including by trafficking drugs. In short, we agree with the government that improving peoples' economic prospects and helping government institutions better deliver needed services -- from security to health and education -- is the most effective way to counter latent support for populist political projects, in Peru and throughout the region. In this sense, we see Peru's continued success as carrying a wider regional significance.

Government Regrouping

17. (SBU) Peru's government is regrouping following the violent events of early June in the Amazon region of northwest Peru that resulted in the deaths of 24 police and 10 civilian protestors (five of them indigenous). While there is still some confusion surrounding the exact details of the clash, there is little doubt that the Peruvian government suffered a debilitating public relations blow, inside and outside Peru. The immediate cause of the protests that preceded the violence -- in addition to longer-term resentment in Amazon areas over state neglect and lack of prior consultation -- were a series of legislative decrees regulating forest management, agricultural credit and land use, and other development issues in the Amazon which indigenous communities believed to be damaging to their interests. (Note: One of these decrees, the forestry law, contained provisions required by the U.S.-Peru Trade Promotion Agreement (PTPA). These provisions included environmental protections and mechanisms to combat illegal logging. End Note). After the violence, sparked when underprepared police tried to clear a blocked road that had practically left nearby cities without food or fuel, Congress repealed two of the decrees in question (including the one related to the PTPA). Since then, President Garcia reshuffled his Cabinet, and the new Ministers are now seeking a way forward through a dialogue process designed to defuse tensions and reassure indigenous communities with respect to the government's intentions.

Congress in Need of Support

¶8. (SBU) The focus of your visit will be your interactions with members of Congress and the inauguration of HDAC's relationship with Peru's legislative branch. Congressional representatives look forward to your visit. Many of Peru's democratic institutions do not enjoy high popular support, but Congress' image is particularly dismal. In a recent poll, Congress has an 11% approval rating. Its perceived ineffectiveness in helping resolve the recent Amazon crisis only exacerbated a serious underlying problem. Calls for broad structural reform have generally resulted in legislative stalemate. Engaging with U.S. legislative counterparts on these kinds of important issues, in the context of the HDAC visit, offers a welcome opportunity to rebuild support for legislative and political party reforms and restore the credibility of Peru's Congress.

¶9. (U) Welcome to Peru.
MCKINLEY